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**FISCAL IMPACT STATEMENT**

**LS 6527**

**BILL NUMBER:** HB 1295

**NOTE PREPARED:** Dec 16, 2004

**BILL AMENDED:**

**SUBJECT:** Inheritance Tax.

**FIRST AUTHOR:** Rep. Whetstone

**FIRST SPONSOR:**

**BILL STATUS:** As Introduced

**FUNDS AFFECTED:** X GENERAL  
X DEDICATED  
FEDERAL

**IMPACT:** State & Local

**Summary of Legislation:** The bill eliminates the classification of transferees for purposes of the Inheritance Tax. The bill provides that any transferee other than a surviving spouse is subject to the exemption amount and Inheritance Tax rates that formerly applied to a Class A transferee. (Under current law a transfer to a surviving spouse is fully exempt from the Inheritance Tax). The bill also repeals classification of transferees provisions.

**Effective Date:** July 1, 2005.

**Summary of Net State Impact:** Under the bill, the state will experience a decrease in Inheritance Tax revenue and an increase in state General Fund expenditures on county Inheritance Tax replacement beginning in FY 2007. The annual net state impact of the bill is summarized in the table below.

<b>Inheritance Tax Revenues</b>	(\$60.3 M)
<b>Add'l. State Expenditures for County Replacement</b>	(2.3 M)
<b>Net Increase (Decrease)</b>	(\$62.6 M)

**Explanation of State Expenditures:** *County Inheritance Tax Replacement:* The bill could increase annual expenditures from the state General Fund for county Inheritance Tax replacement beginning in FY 2007. The additional expenditures for county Inheritance Tax replacement is estimated to total about \$2.3 M annually. This estimate represents an upper bound, and necessary replacement amounts may vary depending on whether and by how much each county's base Inheritance Tax revenue differs from the amount guaranteed under

current statute.

**Explanation of State Revenues:** *Summary:* The bill would reduce Inheritance Tax liabilities of Class B and Class C transferees (persons who are not lineal descendants of the decedent), beginning with property transfers of decedents who die after June 30, 2005. The revenue loss from this bill is estimated to total approximately \$60.3 M annually beginning in FY 2007.

*Background:* The bill eliminates the classification of property transferees for purposes of the Inheritance Tax. To do this, the bill makes the standard exemption and the tax rate structure for Class B and Class C transferees (persons who are not lineal descendants of a decedent) the same as for Class A transferees (lineal descendants of a decedent). Under current law, Class A transferees are entitled to a \$100,000 exemption, while Class B and Class C transferees are entitled to exemptions of \$500 and \$100, respectively. Also, current statute provides for differing tax structures for the three transferee classes. The Class A Inheritance Tax rates range from 1% to 10%, depending upon the net taxable value of transfers from the decedent. However, the Class B tax rates range from 7% to 15% of the net taxable transfer value, and the Class C tax rates range from 10% to 20% of the net taxable transfer value. As a result of the exemption and tax rate differences, effective tax rates for the transferee classes vary substantially, with Class A transferees subject to much lower tax rates. Based on Inheritance Tax return data for decedents who died from July 1, 1997, to September 30, 2003, the effective tax rate varies from 2.3% for Class A transferees, to 8.4% for Class B transferees, to 12.1% for Class C transferees.

The exemption and tax rate changes would apply to transfers made by persons who die after June 30, 2005. Since the Inheritance Tax must be paid within 12 months after the decedent's death (within 9 months to receive the 5% early payment discount), the initial impact would not be experienced until FY 2007.

The estimated impact of the exemption and tax rate changes is based on the Office of Fiscal and Management Analysis (OFMA) Inheritance Tax database and the Revenue Technical Committee's FY 2007 forecast (published December 14, 2004). The forecast estimates FY 2007 Inheritance Tax at \$120.0 M. The estimated revenue loss assumes that Inheritance Tax revenues would remain relatively constant after FY 2007 absent the exemption and tax rate changes.

The Inheritance Tax database is comprised of about 209,000 records of transferees receiving assets from a decedent who died between July 1, 1997, and September 30, 2003. Annual sample totals suggest that Class B transferees account for about 33.8% of annual Inheritance Tax revenue, or about \$40.5 M of the forecast amount. The sample information suggests that Class C transferees account for about 25.8% of the annual total, or about \$31.0 M of the forecast amount. Simulations with the sample returns suggest that the exemption and tax rate changes will reduce Inheritance Tax revenue from Class B transferees by about 82%, and from Class C transferees by about 88%.

#### **Explanation of Local Expenditures:**

**Explanation of Local Revenues:** The exemption and tax rate changes under the bill are estimated to result in an annual net revenue loss to counties totaling about \$3.0 M beginning in FY 2007.

Counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. Counties are guaranteed a statutorily determined amount as determined by the replacement provision established by P.L. 254-1997. The replacement provision was established to replace county Inheritance Tax revenue lost when the

Class A exemption was increased on July 1, 1997. The replacement provision guarantees that each county receives Inheritance Tax revenue equal to the five-year annual average amount of Inheritance Tax received by that county from FY 1991 to FY 1997 excluding the highest and lowest years. The bill is estimated to reduce Inheritance Tax revenue to counties by about \$5.2 M annually. However, the reductions in county Inheritance Tax are expected to trigger additional Inheritance Tax replacement payments from the state General Fund total by about \$2.3 M annually. Both of these impacts would begin in FY 2007.

Currently, most counties retain more in Inheritance Tax revenues than is guaranteed under the replacement procedure. From FY 2000 to FY 2003, counties exceeded their guarantee amounts by an average of \$4.7 M annually with shortages subject to replacement averaging about \$200,000 per year. The total annual guarantee to counties is \$7.4 M. As a result, some reductions in county revenue exceeding the guarantee amount will not be replaced by the state.

A copy of the spreadsheet showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

**State Agencies Affected:** Department of State Revenue.

**Local Agencies Affected:** Counties.

**Information Sources:** State Revenue Forecast (December 14, 2004); OFMA Inheritance Tax database.

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